WRITTEN STATEMENT OF ROBERT E. McKEW,
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Before the Federal Deposit Insurance Corporation
April 10, 2006

Good morning. My name is Bob McKew and I am the general counsel and senior vice president at the American Financial Services Association ("AFSA"). AFSA represents the nations' market rate lenders providing access to credit for millions of Americans. AFSA's 300 member companies include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders, industrial loan companies ("ILCs"), and other financial service firms that lend to consumers and small businesses.

While I am appearing before you in this proceeding regarding the application by Wal-Mart Bank (in organization) for federal deposit insurance, my principal reason to appear on behalf of AFSA today is to try to shift some of the focus to the fundamental proposition that public policy should advance competition and consumer choice in the financial services industry. Moreover, this application should be considered on its merits. It should not be evaluated solely in the context of other unrelated elements that have been injected into this debate, or on revisionist theories regarding the existence of the ILC charter itself.

I commend the Federal Deposit Insurance Corporation ("FDIC") for its thorough review of Wal-Mart's application. It is unfortunate; however, that many opponents of ILCs have chosen Wal-Mart's application as an opportunity to attack ILCs in general. In so doing, they oppose Wal-Mart's application not on its merits, but on a misplaced fear of ILCs as a whole. This fear is unjustified and AFSA would like to provide the facts relating to ILCs to the FDIC on the record.

As you know, ILCs are state-chartered, FDIC-insured banks subject to the same federal banking laws as any other state-chartered, FDIC-insured bank. Many consumer credit products are provided through ILCs, such as auto loans, credit cards, mortgages, and other consumer loan products. Of course, ILCs compete with other consumer lenders in providing these products, resulting in significant competition among financial institutions for consumers. The natural result of this competition is lower prices and improved product offerings in the financial services marketplace.

Unfortunately, there are people and entities who oppose the entire concept of ILCs. The opposition to these federally regulated institutions is generally based on time-tested falsehoods and half truths centered on the fact that ILCs may be owned by commercial entities. While the opposition to ILCs is primarily theoretical and astoundingly speculative, the practical impact of a restriction on the competition provided by ILCs would be a reduction in available credit to consumers. Ironically, several groups purporting to represent the interests of underserved consumers in the credit marketplace oppose the creation of another competitor in the financial services marketplace.

According to those who oppose ILCs, and would therefore restrict consumer access and choice: (i) commercial ownership of ILCs violates a mythical separation of banking and commerce; (ii) ILCs pose an undue risk to the FDIC; and (iii) commercial owners of ILCs can restrict their competitors' access to credit. I would like to address each of these false claims in turn.

Judging by the comments of those who oppose ILCs, one would think that the United States has, and has always had, a general prohibition with respect to commercial entities owning banks. It allegedly follows, then, that the ILC charter somehow violates this sacrosanct principle of bygone days. In fact, there has never been a prohibition on the "mixing of banking and commerce" in the United States. It has been the premise of an "advocacy slogan" for many years, and the premise is and always has been incorrect.

If one looks for the basis of this "premise" in the law, in regulation, or in history, it becomes quite clear that it does not exist. The "perils of mixing of banking and commerce" argument is so worn out that we wonder how many "bankers" actually still cling to this myth behind the doors of their closed vaults. Recent applications by banking entities to engage in new activities suggest that fewer bankers do, in fact, have reservations about allowing banking entities to engage in "commercial" endeavors.

The Bank Holding Company Act ("BHCA") was enacted in 1956. However, the BHCA did not prevent a commercial company from owning a bank until 1970, and even then there were significant "grandfathering" provisions for commercial entities that owned a bank at that time.[1] Therefore, any notion of this oft-mentioned (but illusory) "longstanding prohibition on banking and commerce" were not planted in the BHCA until 1970. Even after 1970, however, commercial firms have had the ability to own banking entities.

Now, we are witnessing the entry of banks into formerly "commercial activities" such as hotel management, energy trading or windmill energy-generation facilities results from the Gramm-Leach-Bliley Act's unleashing of banks. AFSA supports responsible diversification of banking entities' permissible activities.

We believe that the FDIC can effectively assess and manage the incremental risk to the deposit insurance fund, if any, posed by banks' entry into businesses from which they were previously barred. Again, competition in the commercial sector as well as the financial services sector should be a fundamental public policy beacon during the consideration of this application. Consumers benefit by more competition, and, unlike many of the statements which we expect you will hear today, AFSA is entirely consistent in its view on this issue. Parity in financial services is not a one-way street. Moreover, AFSA does not accept the "please protect us from ourselves" argument. Whether it is the effectiveness of tools available to government regulators or the market discipline of financial services providers themselves, the incremental risks, if any, associated with the overlap of "banking" and "commerce" can be effectively assessed and managed by the FDIC. As Federal Reserve Governor Mark Olson stated in a March 13, 2006 speech to the Institute of International Bankers":

[1] Restrictions on the activities of thrift holding companies appeared around roughly the same time, again with several exceptions purposefully made including the "unitary thrift" exception.

> "[T]he act offers a clear acknowledgement that the separation of banking and commerce is not a bright line but is instead a negotiated compromise—one that will continue to move as markets change and products are refined."
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> "[W]e can expect over time to see adjustments in both the direct activities of banks and in the line separating banking and commerce. History is, in some sense, about the drawing, re-evaluation, and re-drawing of lines.

Despite opponents' claims, the ability of commercial entities to own banking operations has never been a "loophole." When revising the law, Congress has gone out of its way to specifically authorize the commercial ownership of various entities. It would be difficult to characterize these specific actions by Congress as a "loophole"—at least in an intellectually honest manner.

Indeed, not only have commercial firms always been able to operate a bank, but it has always been the case that an individual could own a bank and any other type of business. This permissive policy continues today because the ownership restrictions under the BHCA do not apply to individuals, only to companies. Oddly enough, opponents of "banking and commerce" do not appear to view this as a problem. Indeed, neither does AFSA.

Whether the law permitted the ability of commercial firms to own a full service bank, thrift, a credit card bank, an ILC, or any other banking institution, there are no legitimate accusations that the net result was anything other than what Congress intended. To the extent Congress determines it is time for a policy change, Congress can change the law. Despite the enormous publicity surrounding the ILC issue of late, I am aware of no serious effort in Congress to alter the ability of a commercial firm to own an ILC. The characterization of the ILC charter as a "loophole" is just another "advocacy slogan". An "advocacy slogan" should not be permitted to affect public policy simply through sheer repetition by some in the banking world who tell us this proposition is etched in granite somewhere. It need not be said that public policy should, at the very least, be based on facts, logic, and recognition of the true capabilities of the U.S banking system. The capabilities of banking regulators to assess and manage risk has become increasingly robust—especially during the past twenty years or so. The "loophole argument" should be categorically rejected by the FDIC. It simply has no basis in the law-- in fact--or in the entire history of U.S. banking regulation.

For those who believe that there is a long-standing prohibition on the mixing of banking and commerce, it seems curious that no serious opposition was generated to entities like Target, American Express, BMW, General Electric, Sears, General Motors, Pitney Bowes, Volkswagen, Volvo, Federated Department Stores, Ford, Nordstrom, and numerous others that currently operate, or have recently operated, banking entities in addition to their commercial activities. Certainly, no public hearings like this were ever deemed necessary in the FDIC Applications of each of these entities for federal deposit insurance.

And, of course, there are numerous examples of individuals who own banks as well as other commercial businesses as well. Any claim of a "longstanding prohibition" against mixing banking and commerce ignores history and ignores the status quo. It is worth repeating: there has never been a prohibition on the mixing of banking and commerce. It is an oft-propounded myth perpetuated by others with "protectionist" motivations. The myth should be relegated to the dustbin of bankers' advocacy history. The disposal of the "perils of mixing banking and commerce" myth once and for all is way past due.

The fact that there has always been commercial involvement in banking undermines the second argument made by ILC opponents, namely that ILCs (and other similar arrangements) pose an inherent threat to the bank insurance funds. This allegation ignores the fact that since the Federal Deposit Insurance Act ("FDI Act") was enacted there has been no evidence that banks owned by commercial companies are more likely to fail than banks owned by individuals or bank holding companies. Given this lack of evidence, the concern for increased risk of failure due to diversified activities must be based on an unquantifiable philosophical concern that a diversified company places a bank's safety and soundness at risk more than a less diversified company. Yet, Congress recently *expanded* the permissible activities for a bank holding company to include such inherently complicated and risky activities as investment underwriting and insurance underwriting.

Certainly many of the corporate opponents of ILCs do not oppose these types of activities for bank owners as many of them engage in these complicated and risky activities themselves. The ability to accurately assess and manage risk in the effort to increase the enterprise value of any entity, whether it is a bank or a retailer, is an absolute requirement for all managers today. Today's managers cannot hide behind protectionist policies or regulatory "shields". The discipline and benefits of competition will always prevail. Competition should not be feared—it should be embraced. The case has not been made that "selling widgets" (or any other commercial activity) is somehow more risky than the activities already undertaken by bank affiliates and their holding companies. There is a logical disconnect when people allege that bank affiliates or their parent companies can engage in complex derivatives activities and underwrite disaster insurance, but that they cannot sell sweaters due to the risk posed by selling sweaters on the deposit insurance funds. Indeed, it is possible for bank affiliates to engage in any of these activities without posing an inherent risk to the deposit insurance funds.

The allegation of undue risk posed by ILCs and their affiliates also assumes, at least in part, an inherent inability of the FDIC to regulate and examine the ILC and its relationships with its affiliates for safety and soundness concerns. Given the FDIC's expertise in bank regulation, we believe this assumption to be misguided. The allegation also assumes that the FDIC does not have the authority to review the relationships between an ILC and its non-bank corporate owner and/or affiliate(s), making the ILC (and the deposit insurance funds) vulnerable to abuse by the non-bank parent. In fact, the FDIC has the necessary authority to review and prevent such abusive transactions. As former FDIC Chairman Donald E. Powell stated in a letter dated August 29, 2005 to the Government Accountability Office:

- "The FDIC believes that bank-centric supervision as applied by the…FDI Act, and enhanced by Sections 23A and 23B of the Federal Reserve Act and the Prompt Corrective Action provisions of the FDIC Improvement Act, is a proven model for protecting the deposit insurance funds, and no additional layer of consolidated federal supervision of ILC parents is necessary."

- "The FDIC's supervisory philosophy of insulating the insured ILC, bank, or thrift, is rooted in the absolute accountability of insured institution boards of directors for the governance of their institutions. Transaction testing at the insured entity, traced as needed through parent companies and affiliates, is intended to ensure that undue parent company influence is not being exercised…Identifying and addressing inappropriate influence by affiliated entities is included in the scope of every examination, but the degree of insulation the FDIC requires increases substantially as identified risk increases, and can reach the point where the bank is completely walled off from its affiliates with all major decisions requiring FDIC approval."

- "In terms of the relevant goal of safeguarding the federal banking safety net, any conclusion that the FDIC's affiliate examination authority is less effective in practice than that of consolidated supervisors is not supported by the historical record."

Chairman Powell was not the only regulator with the view that consolidated supervision is not always preferable. The Federal Reserve used to agree that protecting the interests of bank depositors and taxpayers does not require oversight by the Federal Reserve – or an extension of the federal safety net – over the entire organization:

> "The case is weak, in our judgment, for umbrella supervision of a holding company in which the bank is not the dominant unit and is not large enough to induce systemic problems should it fail." (Chairman Alan Greenspan, testimony before House Capital Markets Subcommittee, March 19, 1997).

Although Chairman Powell correctly noted that no additional layer of consolidated federal supervision of ILC parents is necessary, it should be noted that the ILCs which hold the vast majority of deposits *are in fact subject to consolidated supervision*. For example, 94% of the deposits held by Utah ILCs are held by banks subject to consolidated supervision, including that of the Office of Thrift Supervision or the Securities and Exchange Commission. We are unaware of any objections to the quality of the consolidated supervision provided by these federal agencies. This point does not imply a need for consolidated supervision. As Chairman Powell explained, the FDIC has the necessary authority to ensure the safety and soundness of ILCs. The statement is simply intended to provide further ammunition against specious arguments with respect to ILCs having inadequate regulatory oversight. It is also unusual that opponents of ILCs generally do not advocate in favor of consolidated supervision as a solution to the ILC "problem." This further suggests a desire to simply eliminate competition from ILCs.

I would like to address one other argument advanced by those who oppose ILCs or would seek to avoid competing with ILCs. According to some, ILCs pose a threat to competition among commercial entities. The reasoning behind this faulty theory is that an ILC will not make loans to competitors of its non-bank owner or affiliates, giving an unfair competitive advantage

to members of the ILC's corporate family. If this were a true concern, banks would not be permitted to affiliate with any kind of entity. Yet banks can affiliate with brokerage companies, insurance companies, mutual fund companies, finance companies and a whole host of other types of companies described in Regulation Y. There is no evidence that these industries, or those whose participants have ILC affiliates, have been hurt by "favoritism" resulting from affiliations with banks. There is good reason for this as financing for business has never been easier to obtain thanks to robust lending and capital markets.

If concern about competition threats due to bank affiliations were truly an issue, whether it is advanced when talking about the insurable risks associated with an ILC or any other type of bank, the concerns would be most valid in rural America, where only one or two banks may operate in a given locality. But the opponents of ILCs have not indicated that "start-up" money is not available for potential competitors to the local bank or its affiliates. Opponents of ILCs do not appear concerned that a person may own both the local bank and the local gas station in rural towns, thereby creating problems for other gas stations trying to enter the market. Nor are they concerned that the local bank owner can also own the local car dealer, perhaps making it more difficult for other car dealers to proliferate due to lack of credit (for themselves or their customers)--Or for pharmacies--Or for dry cleaners. The list could go on. Nor have opponents of ILCs suggested applying the BHCA to individuals. Again, neither does AFSA!

The law allows these affiliations to exist, not because there is a difference between individuals owning banks and corporations owning banks, but because, in either case, abuses are prevented by restrictions against self-dealing. The protections are the same whether the owner is a farmer owning a community bank, a cable television entrepreneur who wants acquire a bank to serve the minority community, or a corporation that wants to serve its customers through an industrial bank.

Given the strenuous objections relating to ILCs and their impact on competition, the silence with respect to similar competitive issues is parallel circumstances is inexplicable. Therefore, the "preservation of competition" argument can best be described as a red herring advanced by those seeking to limit the competition in the banking world provided by ILCs. Is it a good "advocacy slogan"? Maybe, although it has been shot down so many times, it has long lost its luster or credibility. Is it good public policy upon which to base the decision on this application? Absolutely not!

In sum, there has always been some degree of overlap of banking and commerce in the United States. Commercial companies and individuals operating commercial concerns have always owned banking entities, such as national banks, thrifts, or even ILCs. There is no evidence to suggest that ILCs pose an undue risk to the deposit insurance funds. To the contrary, the FDIC has ample regulatory authority with respect to ILCs to protect the federal banking safety net. Additional competitors in the financial services world, including the entrance of new ILCs into the market, will result in more competition for financial services, not less.

In light of the fact that the attacks on ILCs as a form of banking are baseless, we urge the FDIC to consider Wal-Mart's application on its merits, including the strength of its management team and the benefit to consumers if it is granted deposit insurance. Given that the apparent

purpose for the ILC would be to reduce Wal-Mart's operating costs, the likely result would be lower prices for consumers.

Indeed, that is ultimately what this proceeding should be all about. AFSA stands for the proposition that public policy should advance competition and consumer choice in the financial services industry. That is the fundamental reason why I am standing before you today in this application proceeding. Competition and consumer choice are fundamental public policy pillars. AFSA will stand up for competition and consumer choice whenever it is possible to do so. This proceeding is an opportunity to support competition and consumer choice in the financial services industry. I respectfully submit that these policy goals should be regarded as brightly shining beacons in your consideration of this application.

AFSA urges the FDIC to consider Wal-Mart's application on its merits.

This concludes my statement and I would be pleased to answer any questions.

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SUMMARY OF TESTIMONY OF ROBERT E. McKEW,
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The Federal Deposit Insurance Corporation ("FDIC") should consider the application by Wal-Mart Bank for deposit insurance on its merits with due regard to the benefits of competition and consumer choice in the financial services industry.

Industrial loan companies ("ILCs") are state-chartered, FDIC-insured banks subject to the same federal banking laws as any other state-chartered, FDIC-insured bank. The existence and legal basis of ILCs are not new. ILCs were in existence long before the creation of the Federal Reserve System in the United States. The opposition to these federally regulated institutions is generally based on repeatedly asserted (and repeatedly rejected) falsehoods and half truths centered on the fact that ILCs may be owned by commercial entities. While the opposition to ILCs is primarily theoretical and astoundingly speculative, the practical impact of a restriction on the competition provided by ILCs would be a reduction in financial products offered in the marketplace.

Opponents of the continued existence and advancement of ILCs seek to restrict competition and consumer access and choice. According to those who oppose ILCs, the longstanding existence of the entire ILC charter should be examined in this proceeding. AFSA expects that at least three of the usual arguments against ILCs will be advanced in this proceeding. The three "premises" are: (i) commercial ownership of ILCs violates a mythical separation of banking and commerce; (ii) ILCs pose an undue risk to the FDIC; and (iii) commercial owners of ILCs can restrict their competitors' access to credit. Each premise is incorrect.

In fact, there has never been a prohibition on the "mixing of banking and commerce" in the United States. Moreover, not only have commercial firms always been able to operate a banking entity, but it has always been the case that an individual could own a bank and any other type of business. This permissive policy continues today because the ownership restrictions under the Bank Holding Company Act do not apply to individuals, only to companies.

The allegation of undue risk posed by ILCs ignores the fact that since the Federal Deposit Insurance Act was enacted there has been no evidence that banks owned by commercial companies are more likely to fail than banks owned by individuals or bank holding companies. The allegation of undue risk posed by ILCs and their affiliates also assumes, at least in part, an inherent inability of the FDIC to regulate and examine the ILC and its relationships with its affiliates for safety and soundness concerns. This is an incorrect assumption. The FDIC has the appropriate tools to prevent and correct problems that may be actual or perceived in the relationship between an ILC and its affiliates.

By definition, deposit insurance involves the assessment and management of risk in the activities of the insured institution. Any risk that may be perceived to be an actual or potential problem by the activities of an ILC and its affiliate is presently, and will continue to be,

effectively assessed and managed by the FDIC. AFSA believes that the FDIC already has the necessary tools to effectively assess and manage risk to the deposit-insurance fund. If, later, it is determined that additional or different tools are needed by the FDIC to effectively assess and manage any type of risk to the insurance fund, regardless of how it may be manifested, the appropriate latitude and authority should be provided to address that risk.

According to some, ILCs pose a threat to competition among commercial entities. The reasoning behind this faulty theory is that an ILC will not make loans to competitors of its non-bank owner or affiliates, giving an unfair competitive advantage to members of the ILC's corporate family. If this were a true concern, banks would not be permitted to affiliate with any kind of entity. Yet banks can affiliate with an array of other types of companies described in Regulation Y. There is no evidence that these industries, or those whose participants have ILC affiliates, have been hurt by "favoritism" resulting from affiliations with banks.

If concern about competition threats due to bank affiliations were truly an issue, whether it is argued as to an ILC or any other type of bank, the concerns would be most valid in rural America, where only one or two banks may operate in a given locality. Opponents of ILCs have not suggested, however, applying the Bank Holding Company Act to individuals.

There has always been an overlap of banking and commerce in the United States. Commercial companies and individuals operating commercial concerns have always owned banking entities, such as national banks, thrifts, or even ILCs. There is no evidence to suggest that ILCs pose an undue risk to the deposit insurance funds. To the contrary, the FDIC has ample regulatory authority with respect to ILCs to protect the federal banking safety net. Additional competitors in the financial services world, including the entrance of new ILCs into the market, will result in more competition for financial services, not less.

AFSA stands for the proposition that public policy should advance competition and consumer choice in the financial services industry. That is the fundamental reason why I am standing before you today in this application proceeding. Competition and consumer choice are fundamental public policy pillars. AFSA will stand up for competition and consumer choice whenever it is possible to do so. This proceeding is an opportunity to support competition and consumer choice in the financial services industry. I respectfully submit that these policy goals are beacons that should be considered in your final decision.

AFSA urges the FDIC to consider Wal-Mart's application on its merits.

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